

Internal Revenue Service

Department of the Treasury

Number: **200243035**
Release Date: 10/25/2002
Index Number: 163.10-00

Washington, DC 20224

Person to Contact:

Telephone Number:
(202)622-3870
Refer Reply To:
International-PLR-143650-01
Date:
July 22, 2002

Legend:

Taxpayer =
Country A

Date A
Date B =
Date C
Date D

=
Amount A

=
=
=
=

Dear :

This is in reply to a letter from your representative dated August 6, 2001 requesting a ruling under section 163(j) that disallowed interest expense carryforward determined for the taxable years ending Date A through Date B no longer be considered disqualified interest with respect to the taxable year ending Date D (and therefore be deductible in that taxable year) on the ground that Taxpayer incurred no additional disqualified interest after the taxable year ending Date B.

Facts Represented:

PLR-143650-01

Taxpayer represents the facts as follows. Taxpayer is a wholly owned U.S. subsidiary of Parent, a corporation organized under the laws of Country A. Taxpayer incurred interest expense on indebtedness guaranteed by Parent for the taxable years ending Date A through Date B. Taxpayer claimed benefits under the applicable income tax treaty between the United States and Country A reducing the rate of withholding tax on such interest. For the taxable years ending Date A through Date B, Taxpayer reported that it had paid or accrued “disqualified interest” within the meaning of section 163(j)(3)(B), a portion of which was disallowed under section 163(j)(1)(A) and carried forward under section 163(j)(1)(B).

During the taxable year ending Date B, Taxpayer obtained new debt financing from unrelated parties, which resulted in Parent no longer being a guarantor of any of Taxpayer’s debt. Taxpayer incurred, reported, and deducted additional interest expense for the taxable years ending Date C and Date D, but claimed no deductions in those taxable years for interest expense previously disallowed and carried forward under section 163(j)(1)(B). Accordingly, as of Date B, the records of Taxpayer show an accumulated disallowed interest expense carryforward of Amount A.

Applicable Law:

Section 163(a) of the Internal Revenue Code allows as a deduction all interest paid or accrued within the taxable year on indebtedness.

Section 163(j)(1)(A) provides that if section 163(j) applies to any corporation for any taxable year, no deduction shall be allowed for disqualified interest paid or accrued by such corporation during such taxable year. The amount disallowed shall not exceed the corporation’s excess interest expense for the taxable year.

Section 163(j)(3)(B) provides that “disqualified interest” includes certain interest paid or accrued by the taxpayer with respect to any indebtedness to a person who is not a related person if (i) there is a disqualified guarantee of such indebtedness, and (ii) no gross basis tax is imposed with respect to such interest.

Under section 163(j)(6)(D)(i)(II), a “disqualified guarantee” includes any guarantee by a related person (as defined in section 163(j)(4)) which is a foreign person. The term “related person” is defined in section 163(j)(4)(A) to mean any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

Under section 163(j)(6)(E)(i), the term “gross basis tax” means any tax imposed by Subtitle A of the Internal Revenue Code which is determined by reference to the gross amount of any item of income without any reduction for any deduction allowed by Subtitle A. Under section 163(j)(5)(B), if any treaty between the United States and any foreign country reduces the rate of tax imposed by Subtitle A on any interest paid or accrued by the taxpayer, such interest shall be treated as interest on which no tax is

PLR-143650-01

imposed by Subtitle A to the extent of the same proportion of such interest as (i) the rate of tax imposed without regard to such treaty, reduced by the rate of tax imposed under the treaty, bears to (ii) the rate of tax imposed without regard to the treaty.

Section 163(j)(2)(A) provides that section 163(j) shall apply to any corporation for any taxable year if (i) such corporation has excess interest expense for such taxable year, and (ii) the ratio of debt to equity of such corporation as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5 to 1.

Section 163(j)(2)(B)(i) defines “excess interest expense” to mean the excess, if any, of (I) the corporation’s net interest expense, over (II) the sum of 50% of the adjusted taxable income of the corporation plus any excess limitation carryforward calculated in accordance with section 163(j)(2)(B)(ii).

Under section 163(j)(6)(B), the term “net interest expense” means the excess, if any, of (i) the interest paid or accrued by the taxpayer during the taxable year, over (ii) the amount of interest includible in the gross income of such taxpayer for such taxable year. Net interest expense must be determined by taking into account all interest actually paid or accrued by the taxpayer during such taxable year, including interest expense that would not be treated as disqualified interest under section 163(j)(3). However, for purposes of section 163(j)(6)(B), net interest expense for a taxable year does not take into account any disallowed interest expense carried forward to such year and treated as disqualified interest under section 163(j)(1)(B).

Under section 163(j)(6)(A), the term “adjusted taxable income” means the taxable income of the taxpayer (i) computed without regard to deductions allowable for net interest expense, net operating losses, depreciation, amortization, or depletion, and (ii) computed with such other adjustments as the Secretary may by regulations prescribe.

Section 163(j)(2)(B)(iii) defines “excess limitation” to mean the excess, if any, of (I) 50% of the adjusted taxable income of the corporation, over (II) the corporation’s net interest expense.

Section 163(j)(2)(B)(ii) provides that if a corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an “excess limitation carryforward” to the first succeeding taxable year and to the second and third succeeding taxable years to the extent not previously taken into account. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

Section 163(j)(1)(B) provides that any amount disallowed under section 163(j)(1)(A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year. A parenthetical, added to section 163(j)(1)(B) by P.L. 104-

PLR-143650-01

188, sec. 1704(f)(2)(A), provides that section 163(j)(2)(A)(ii) shall not apply for purposes of applying section 163(j)(1) to any amount disallowed and treated as disqualified interest paid or accrued in a succeeding taxable year. Thus, amounts treated as disqualified interest that are disallowed in one taxable year will continue to be classified as disqualified interest in succeeding taxable years even if the taxpayer satisfies the debt/equity safe harbor of section 163(j)(2)(A)(ii) for such succeeding taxable years.

No final regulations have been issued under section 163(j).

Analysis:

For the taxable years ending Date A through Date B, Taxpayer represents that it incurred interest expense on indebtedness guaranteed by Parent, a person related to Taxpayer under section 163(j)(4)(A) and a foreign person within the meaning of section 7701(a). Taxpayer further represents that the Parent guarantee was a “disqualified guarantee” within the meaning of section 163(j)(6)(D)(i)(II), that Taxpayer paid or accrued interest expense with respect to which a deduction was disallowed under section 163(j), and that Taxpayer had an accumulated carryforward of disallowed interest expense of Amount A on Date B.

During the taxable year ending Date B, Taxpayer represents that it obtained new debt financing from unrelated parties, which resulted in Parent no longer being a guarantor of any of Taxpayer’s debt. Accordingly, Taxpayer did not pay or accrue any additional disqualified interest after the taxable year ending Date B. Notwithstanding this fact, under section 163(j)(1)(B), the Amount A of accumulated disallowed interest expense carried forward from the taxable year ending Date B is required to be treated as disqualified interest paid or accrued in the succeeding taxable years. Taxpayer’s carryforward of disallowed interest expense therefore remains subject to the deduction limitations of section 163(j) in such succeeding taxable years.

Based on the foregoing, it is held as follows:

1. As of Date B, Taxpayer represents that it had an accumulated carryforward of disallowed interest expense of Amount A. This amount will be treated as disqualified interest paid or accrued in the succeeding taxable year (i.e., the taxable year ended Date C) even though Parent no longer guarantees any of Taxpayer’s debt. The amount of disqualified interest disallowed for the taxable year ended Date C will be limited to Taxpayer’s excess interest expense, if any, for that taxable year.
2. Any disqualified interest treated as having been paid or accrued by Taxpayer for its taxable year ended Date C which is not deductible in such taxable year by reason of the application of section 163(j) will be treated as disqualified interest paid or accrued in the succeeding taxable years and allowed as a deduction to the extent provided under section 163(j). Thus, the amount of disqualified

PLR-143650-01

interest disallowed for the taxable year ended Date D will be limited to Taxpayer's excess interest expense, if any, for that taxable year.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and its representative and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 12.04 of Rev. Proc. 2002-1, 2002-1 I.R.B. LEXIS 63, 118. However, when the criteria in section 12.05 of Rev. Proc. 2002-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,
Jeffrey Dorfman
Chief, Branch 5
Office of Office of Associate Chief Counsel
(International)

Enclosures:
Copy of letter
Copy for section 6110 purposes
cc: